AMERICAN BENEFITS COUNCIL

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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N–5655
U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, D.C. 20210

RE: RIN 1210-AB59 – Brokerage Windows RFI
Comment on Request for Information Regarding Standards for Brokerage Windows in Participant-Directed Individual Account Plans

Dear Sir or Madam:

The American Benefits Council ("Council") appreciates the opportunity to provide comments and information in response to the Department of Labor's request for information ("RFI") regarding standards for brokerage windows in participant-directed individual account plans. Moreover, the Council very much values and supports the Department's use of the RFI process to collect and evaluate information from stakeholders prior to considering what additional steps, if any, the Department may take with respect to brokerage windows.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either directly sponsor or provide services to retirement and health plans that cover more than 100 million Americans.

In brief, we strongly believe that the Department has already provided sufficient guidance on brokerage windows to serve the needs of plan sponsors and to protect participants. ***In this regard, the Council is deeply concerned about the potential for***

additional guidance or requirements related to brokerage windows to (1) have an adverse effect on the ability of plan sponsors to offer brokerage windows to their employees and (2) consequently, reduce both plan participation and sponsorship.

The Council is a longtime supporter of the Department's efforts to promote transparency with respect to fee and other plan information. We appreciate the multiple efforts that the Department has undertaken to thoughtfully develop regulations and guidance for plan sponsors and fiduciaries regarding their disclosure-related responsibilities. One such effort was the issuance of Field Assistance Bulletin ("FAB") 2012-02, which generally provided helpful interpretive guidance regarding the final participant-level disclosure regulation.[1] As discussed in more detail below, after Q&A-30 in FAB 2012-02 raised critical concerns for plan sponsors regarding their duties with respect to brokerage windows, we very much appreciated the Department's willingness to consider these concerns and, subsequently, to address them in FAB 2012-02R with new Q&A-39.

In Q&A-39, the Department noted with respect to brokerage windows that "plan fiduciaries and service providers may have questions regarding the situations in which fiduciaries may have duties under ERISA's general fiduciary standards apart from those in the [participant-level disclosure regulation]." While our members did have such questions following the issuance of the participant-level disclosure regulation and especially FAB 2012-02, the Council's members have found that ***the regulation and FAB 2012-02R together are working very well to give plan sponsors and service providers appropriate, workable requirements and the guidance they need to understand the scope of their responsibilities while also ensuring that participants are not exposed to undue risks.***

Considering the potentially adverse consequences of further – and unnecessarily – regulating brokerage windows (as described in more detail below), the Council respectfully requests that the Department continue to utilize a deliberate approach to determining whether additional guidance is necessary. If any changes are proposed, we look forward to working with the Department to ensure that plans and participants are not inadvertently harmed in the process.

SUMMARY OF THE COUNCIL'S COMMENTS ON THE RFI

As explained in more detail below, and with references to specific questions asked by the Department, the Council has the following comments in response to the RFI.

[1] 75 Fed. Reg. 64,910 (Oct. 20, 2010), codified at 29 C.F.R. 2550.404a-5 and 29 C.F.R. 2550.404c-1.

1. The Department should maintain the current definition of "brokerage window," which is working well. "Designated investment alternatives" ("DIAs") are investment options that are designated by the plan fiduciary as having been pre-screened; brokerage window investments are investments that are presented as having not been pre-screened. This regulatory distinction works effectively.

2. Brokerage windows are important tools that allow plan sponsors to meet the needs of the majority of participants who benefit from a concise plan menu of DIAs and also satisfy the small portion of participants and plan sponsors who desire access to a broad array of investment options. The current regulatory regime facilitates the use of brokerage windows in this manner as a helpful solution, and any new guidance should not discourage their use in meeting participants' and plan sponsors' needs and aiding greater retirement savings.

3. The imposition of greater fiduciary responsibilities to monitor and evaluate brokerage window investments and provide additional investment-specific disclosures would be unworkable for plan sponsors. The existing disclosure requirements with respect to brokerage windows strike an appropriate balance by providing participants with sufficient information to make informed decisions without inundating them with an overwhelming volume of material.

4. Plan sponsors would benefit from additional guidance on how a fiduciary can liquidate one or more brokerage window investments without the risk of fiduciary liability. Plan sponsors also need the Department to work with the Treasury Department on ways to permit the closure of access to a brokerage window without running afoul of the nondiscrimination rules under the Internal Revenue Code. If new burdens are added to brokerage windows, then guidance on the liquidation of brokerage window investments and closing a brokerage window would be needed simultaneously because many employers would be forced to liquidate or close their brokerage windows.

5. Great care must be taken to ensure that any new guidance or requirements of plan sponsors with respect to brokerage windows do not produce unintended consequences for other types of plans or accounts that use a brokerage window or similar feature, such as SEP and SIMPLE plans. Prior to its modification, the position stated in Q&A-30 would have threatened the continued viability of those plans.

COMMENTS IN RESPONSE TO THE RFI

1. The current definition of "brokerage window" is effective and clear. (*RFI Questions 2, 8*)

The Department asked, as a regulatory or interpretive matter, how "brokerage window" should be defined if a more specific definition is provided.[2] **(*Question* 2)** The term "brokerage window" is currently defined in the participant-level disclosure regulation, the service provider fee disclosure regulation and FAB 2012-02R as those investments that "[enable] participants and beneficiaries to select investments beyond those designated by the plan."[3] In addition, the term brokerage window is excluded from the meaning of "designated investment alternative."[4]

The Council strongly urges the Department to maintain the current definition of "brokerage window." Very importantly, the current definition of brokerage window enables plan sponsors and participants to easily distinguish between a particular investment option that is one of the plan's DIAs (*i.e.*, an option on the plan "menu") and one that is not a DIA but is simply made available through a brokerage window. This definition works just as it should. If the plan fiduciary designates specific investment options, those designations convey to participants that the plan fiduciary is standing behind those options, and fiduciary obligations (including disclosure responsibilities) should and do apply. On the other hand, if the plan fiduciary allows participants to invest in options that are not designated by the plan fiduciary, such as the options available through a brokerage window, it is clear to the participants that the plan fiduciary has not screened such options, so no fiduciary or disclosure obligations should or do apply with respect to such options. That is the rule under the current definitions of "DIA" and "brokerage window," and we believe that the rule and the definitions are working very well for both plans and their participants.

In this regard, it is critical that, as under current law, the mere action of *excluding* certain types of investments from a brokerage window does not result in the remaining investments available through the window being treated as having been specifically pre-selected or designated by the fiduciary.[5] For example, some plan sponsors may offer a mutual fund "supermarket," allowing participants to invest in thousands of available mutual funds. Under current law, the exclusion of individual securities from this window does not transform the funds available under the window into DIAs because

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[2] References in this letter to "brokerage windows" also generally encompass the term "self-directed brokerage account" and other similar plan arrangements.

[3] 29 C.F.R. §§ 2550.404a-5(c)(1)(i)(F), 2550.404a-5(h)(4), and 2550.408b-2(c)(1)(viii)(C) (substituting the term "covered plan" for "plan"); FAB 2012-02R questions 13, 14, 29, and 39.

[4] *See, e.g.*, 29 C.F.R. § 2550.404a-5(h)(4). Designated investment alternative means any investment alternative designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term "designated investment alternative" shall not include "brokerage windows," "self-directed brokerage accounts," or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

[5] As recognized by the Department of Labor regulations under Section 404(c) of ERISA, it may be necessary for a fiduciary to place certain restrictions on plan investments in order to, for example, maintain a plan's qualified status or avoid prohibited transactions. *See* 29 C.F.R. § 2550.404c-1(d)(2)(ii) and (d)(3).

clearly the thousands of available funds have not been "designated." Moreover, if this logical current-law rule were changed, the result in many cases would be for the plan sponsor to have to permit individual securities to be purchased through the window, so as to avoid the unworkable duty to screen and provide disclosures with respect to thousands of mutual funds. No policy purpose would be served by treating the mutual fund supermarkets in this example or similar arrangements as DIAs.

In a related question, the Department asked at what point the number of investment options available to plan participants might warrant treating the options as a brokerage window rather than as a menu of DIAs. **(*Question 8*)** In short, and as described above, the current definition of brokerage window works very well and should not be altered so that the number of investment options dictates how an option is categorized. The critical distinction between a DIA and a brokerage window should remain whether the plan fiduciary pre-selected and "designated" the investment.

2. Brokerage windows are an important tool for plan sponsors that can benefit all participants, whether they utilize the feature or not. (*RFI Questions 17, 18*)

The Department requested comments on the common reasons plan fiduciaries have for adding a brokerage window feature to a plan and the factors they take into account when deciding whether to do so. **(*Questions 17, 18*)**

Low usage

For purposes of context, it is helpful to keep in mind that although the availability of brokerage windows is relatively common, usage of brokerage windows in plans that have DIAs is low. There are various estimates of the percentage of plans that contain brokerage windows as options. The estimates seem to vary primarily based on the size of the plan sponsor. For example, a Vanguard study shows that 11 percent of Vanguard plans with fewer than 1,000 participants offer a brokerage window, while 28 percent of Vanguard plans with greater than 5,000 participants offer such a feature.[6] So on a participant-weighted basis, brokerage windows are certainly common, especially in combination with mutual fund windows, which meet the definition of brokerage windows, as discussed above.

This data supports a key point discussed below. There is important demand for the investment flexibility that a brokerage window permits. As discussed below, if this demand cannot be satisfied through a brokerage window, the fear is that the number of DIAs may be increased. Second, although the data shows greater prevalence of brokerage windows among larger plans, it is our understanding that in the case of the

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[6] *See* Vanguard, *How America Saves* at 49 (2014).

small plans that offer brokerage windows, the windows may be a critical element in the owner's decision to move forward with sponsoring a plan.

Finally, although the data shows that offering a brokerage window is relatively common, use of the window is relatively uncommon. For example, a recent Vanguard report found that only one percent of participants actually use brokerage windows when they are available.[7] Other estimates are slightly higher, with a few estimates as high as five or six percent. But the key point is that usage is extremely low, underscoring another important point. The availability of the window serves a significant purpose, but the vast majority of participants do not use the window at all, showing that any concerns based on the possible proliferation of window investments may not be well founded.

Maintaining a smaller group of DIAs

The very low participant utilization rate of brokerage windows naturally leads one to question why a plan sponsor would offer the feature in the first place. The data supports what our experience has shown is the most common reason provided for adding a brokerage window: it offers a solution to the requests that generally come from a small group of employees for significantly expanded investment opportunities beyond those provided in a typical plan menu. Brokerage windows allow plan sponsors to meet the desires of these employees, while keeping the number of DIAs on the plan menu at a lower number, which is very often more appropriate and beneficial for the vast majority of participants.

In FAB 2012-02, the Department referenced the notion of a "manageable number of investment alternatives" in Q&A-30 and stated that "[u]nless participants and beneficiaries are financially sophisticated, many of them may need guidance when choosing their own investments from among a large number of alternatives." The Council shares this concern, which strongly supports our position. The consequences of providing too many designated investment choices can be adverse in some cases. In fact, studies have shown that 401(k) plan participation can, in some cases, actually decline as the number of investment options offered increases.[8] This has led many companies to use brokerage windows to avoid this very problem. Brokerage windows allow plans to avoid the very real risks of confusing or even paralyzing a large portion of their employees, while at the same time satisfying the desires of a smaller group of participants for more investment flexibility. If brokerage windows become unavailable as a practical matter due to the imposition of unworkable rules, more investment options will likely be designated, which may not be the optimal result in many

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[7] *See* Vanguard, *How America Saves* at 55 (2014).

[8] *See, e.g.*, Sheena Sethi-Iyengar et al., *How Much Choice is Too Much?*, *in* PENSION DESIGN AND STRUCTURE: NEW LESSONS FROM BEHAVIORAL FINANCE 83, 88-91 (Olivia S. Mitchell & Stephen P. Utkus eds., 2004), *available at* http://www.columbia.edu/~ss957/articles/How_Much_Choice_Is_Too_Much.pdf.

circumstances. And for some employers, the increased costs associated with offering more DIAs could adversely affect plan benefits.

Avoidance of fiduciary or disclosure obligations not a factor

The Department also asked what role, if any, concerns about fiduciary responsibility or disclosure obligations play in the decision to add a brokerage option. **(*Question 18*)** Among our members, we have not heard of any company that uses a brokerage window to reduce its fiduciary or disclosure obligations. It is certainly possible that such a perspective exists somewhere, but it would do the system a great disservice to impose unworkable burdens on thousands of plans to address a very isolated problem. For small employers in particular who are understandably more likely to consider the fiduciary and disclosure obligations related to sponsoring a plan, the system has already provided them with options to reduce these burdens, such as through payroll deduction IRAs and SEP and SIMPLE plans.

Brokerage windows can be key to plan formation for small employers

While plan sponsors weigh several factors in determining whether to offer a brokerage window, the ability to offer a brokerage window is itself a factor that many employers consider when deciding whether to sponsor a retirement plan in the first place. Small business owners often insist on a mix of core plan menu options and the investment and cost flexibility of a brokerage window. Commentators have observed informally that the unavailability of brokerage windows or an increase in the burdens associated with offering brokerage windows would have a significant adverse effect on the maintenance and adoption of retirement plans by small employers.

3. **The imposition of greater fiduciary responsibilities to monitor and evaluate brokerage window investments and provide investment-specific disclosures would be unworkable and would significantly increase costs and administrative complexity for plan sponsors. (*RFI Questions 22, 23, 29*)**

The Department asked how plan fiduciaries monitor investments made through their plan's brokerage window, if at all **(*Question 22*)**, and whether fiduciaries view this information as important to effectively monitoring the inclusion of a brokerage window feature in their plan **(*Question 23*)**. The Council appreciates the Department's inquiry on this matter as it is important to stress how unworkable and cost-prohibitive it would be to impose a general obligation on plan fiduciaries to monitor a plan's brokerage window investments. Just as unworkable would be a resulting requirement to provide disclosures similar to those provided to participants with respect to DIAs for a plan's brokerage window investments.

As background for our comments, Q&A-30 of FAB 2012-02 (prior to its modification by FAB 2012-02R) set forth for the first time a requirement that plan fiduciaries examine all brokerage window investments in which a "significant number" of participants and beneficiaries have invested and determine whether plan disclosures should be provided with respect to one or more of such investments. This position was contrary to the [still current] participant-level disclosure regulation under which disclosure is required with respect to the DIAs on the plan menu, but disclosure is not required with respect to the tens of thousands of investments available through the brokerage window. The current rule makes sense because (1) it is impractical for plan sponsors to make disclosures with respect to tens of thousands of different public and private investments, and (2) any applicable disclosure should be governed by the securities laws, since the plan sponsor has not endorsed investments available only through the brokerage window.

Following the issuance of Q&A-30, the Council expressed its concerns with the unworkability of the new requirement in a June 14, 2012, letter to the Department.[9] Because many of the concerns we expressed then are just as relevant today, we reiterate them here to urge the Department not to impose unworkable fiduciary responsibilities to monitor and examine brokerage window investments that will give many plan sponsors no choice but to terminate the brokerage window feature, or in some cases, even the entire plan.

- ***Manual monitoring:*** Very few plan service providers, including brokerage window providers, have a system that can determine the number of participants who are invested in any particular brokerage window investment. Thus, generally, determinations such as those that would have been required by Q&A-30 would need to be done manually, triggering enormous costs and added complexity in plan administration.

- ***Fiduciary issues:*** If a new fiduciary responsibility results in a plan sponsor's determination that disclosure with respect to brokerage window investments is needed because of, to use the example of Q&A-30, the number of participants invested in a brokerage window investment (or by some other standard), such disclosure may cause the investment to be treated as or deemed to be a DIA. This in turn could result in the designation of investments that are not suitable to be included in the fiduciary-reviewed investment offerings or that are inappropriate for the plan sponsor, such as stock of a competitor. Accordingly, there may be a need to immediately liquidate the newly designated investments or to close access to a particular investment once it is possible that the "significant" participation (or other similar) threshold will be exceeded.

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[9] Letter from Lynn Dudley, Senior Vice President, Policy, American Benefits Council, to the Honorable Phyllis C. Borzi, Assistant Secretary, EBSA (June 14, 2012), *available at* http://www.americanbenefitscouncil.org/documents2012/401k-fee_qa30_council-borzi-letter071412.pdf.

The Council strongly objects to the idea that the monitoring of investments made through a brokerage window is important in order to effectively monitor the inclusion of a brokerage window feature by plan sponsors in their plan. **(*Question 23*)** The investments available through a brokerage window are not presented to participants as having been screened by the plan fiduciary; such investments are presented as market investments that may be used outside the oversight of the fiduciary. Thus, there is no duty to monitor those investments. Moreover, if the law is changed so that the employer is forced to exercise oversight over the entire market available through a brokerage window, such a change would be the functional equivalent of prohibiting brokerage windows. In light of the critical role that brokerage windows play in keeping the number of DIAs down, the system would not be well served by such an effective prohibition.

At the same time, it is important to note that current law is structured to require exactly the type of fiduciary oversight of brokerage windows that is appropriate. Plan fiduciaries must monitor their service providers with respect to fees and services, which is exactly what is needed by participants. This is an appropriate result given the very idea behind brokerage windows – that a participant be given freedom to choose from a broad range of investments *outside of* those designated by the plan fiduciary.

In a matter closely related to the monitoring issue discussed above, the Department asked whether any additional information about brokerage windows should be disclosed to participants. **(*Question 29*)** In addition to its concern over new monitoring duties, the Council is also concerned about the unworkability of plan sponsors being required to provide new disclosures with respect to specific investments within a brokerage window. Not only does this raise enormous cost and procedural concerns for the plan, but such a requirement would very likely result in participants being flooded with new disclosures many times more voluminous than those they already receive with respect to their plan. Further, participants electing to use a brokerage window are already expected to complete account level documentation with the brokerage window provider and are provided with account information from the brokerage firm. Those steps ensure that a participant has access to information about his or her new account, and it further supports the fact that an individual is acting in an independent manner with respect to the brokerage window.

The Department acknowledged the risk of overwhelming participants in FAB 2012-02R. In Q&A-13, which very helpfully describes the information required to meet the existing disclosure requirements with respect to brokerage windows, the Department states that the plan sponsor need only provide a general statement regarding brokerage window fees. A general statement is explained as being sufficient in part because plan sponsors may not always know all the various fees associated with each investment option. But the Department also cautioned that ***more detailed fee information "might inundate participants and beneficiaries with information about the cost of buying or***

selling all the various securities available through a window" despite the fact that they might not either utilize the brokerage window or have interest in any such securities.

The Council strongly supports the existing disclosure rules and believes that they strike the right balance in providing enough information to protect participants without being so burdensome that they become overwhelming and irrelevant to participants and increase costs and complexity for plan sponsors. Thus, we believe that additional disclosure rules – especially with respect to the investment options available through a brokerage window – are not necessary; on the contrary, such additional rules would be very counterproductive.

4. Plan sponsors would be placed in an extremely difficult position if new fiduciary or disclosure requirements force plan sponsors to unwind their brokerage window. *(RFI Question 37)*

If the Department decides to impose new fiduciary responsibilities or substantial disclosure requirements on plan sponsors who offer brokerage windows (especially where the requirements in any way resemble the position in Q&A-30), certain negative outcomes are likely. As described above, some brokerage window investments may need to be liquidated. For example, if new guidance results in a brokerage window investment option being treated as or deemed to be a DIA, this could result in a plan sponsor needing to immediately liquidate the newly designated investment or close access to a particular investment if (1) the fiduciary is not prepared to include that investment among the options presented to participants as having been screened, or (2) the investment is inappropriate for the plan sponsor, such as stock of a competitor.

In fact, if affected plan sponsors determine that, as a practical matter, they cannot comply with a new requirement or afford its cost, many will likely conclude that they will be effectively forced to terminate their brokerage window arrangements entirely and liquidate all participants' brokerage window investments. Such liquidations of some or all brokerage window investments could be very harmful to participants.

- The liquidation could occur at a disadvantageous time, forcing participants to sell long-term investments "at the bottom."

- The liquidation could disrupt long-term investment and retirement strategies, undermining a participant's plans regarding how to achieve retirement security.

- The liquidation could deprive participants of the use of certain investment tools not available among the DIAs.

- Participants who do not make affirmative elections regarding reinvestment of the liquidation proceeds may be defaulted into investments that are quite different

from their brokerage window investments and do not fit with their other investments.

To avoid these adverse effects on participants and to avoid potential participant lawsuits and adverse employee relations effects, plan fiduciaries may want to close the brokerage window to new investments, but grandfather existing brokerage window investments. This could potentially cause excessive burdens under any new requirements from the Department, and thus this participant-friendly approach may be unavailable as a practical matter. But even if this approach were available, it would not be workable without relief from the Treasury Department, because such a grandfather situation would very likely violate the nondiscrimination issues under the Internal Revenue Code either immediately or over time.

Under Code Section 401(a)(4) and the regulations thereunder, any plan investments must be available to a nondiscriminatory group of participants. If the group investing in a brokerage window is disproportionately higher paid when the window is closed to new entrants, the plan would immediately fail to satisfy the Code's nondiscrimination rules. Even if the group is not disproportionately higher paid when the window is closed, it is very likely that over time the group will become so, because grandfathered groups almost always become disproportionately higher paid over time. This occurs because (1) turnover is generally higher among lower-paid employees, and (2) many lower-paid employees in the grandfathered group become higher paid over time if they stay with the employer.

The Department asked generally in the RFI whether there is a need for any additional guidance to clarify ERISA's fiduciary duties with respect to a brokerage window. **(*Question 37*)** The Council's members would find it helpful – and essential if burdensome new rules apply to brokerage windows – if the two situations described above can be addressed, *i.e.*, (1) how a fiduciary can liquidate brokerage window investments without risk of fiduciary liability, and (2) how a plan sponsor can avoid such liquidations by closing a brokerage window to new participants without violating the nondiscrimination rules under the Code. It would be of great concern if the Department were to move forward with rules that make brokerage windows difficult to maintain unless the Department (1) provides a safe means to liquidate a brokerage window and (2) works with Treasury on a workable means to close a brokerage window to new entrants. Such guidance would need to be carefully considered and should not undercut existing rules, including guidance on qualified default investment alternatives pursuant to ERISA Section 404(c)(5).

5. Great care must be taken to ensure that any new guidance on brokerage windows does not have unintended consequences, such as threatening the continued viability of SEP and SIMPLE plans.

When the Department released FAB 2012-02, the Council also expressed its concern in the letter to the Department[10] that the Department's position in Q&A-30 would have called into question the viability of all SEPs and SIMPLE IRAs, two of the most popular forms of small business plans. While the participant-level disclosure regulations do not apply to such plans, the position expressed in Q&A-30 seemed to operate independently of (and in contradiction to) the applicable regulations. As described above, Q&A-30 would have imposed an affirmative obligation on plan fiduciaries to examine those investment options that were selected through a brokerage window by a "significant number" of participants and beneficiaries. The fiduciary would then have been required to determine whether those investments should be treated as DIAs for purposes of the participant-level disclosure regulation. Because many SEPs and SIMPLE IRAs are essentially comprised of just a brokerage window, the application of Q&A-30 to these arrangements would have raised enormous problems and for all practical purposes could have shut them down.

As we stated in our 2012 letter, we did not believe that the Department intended for Q&A-30 to apply to SEP and SIMPLE plans, and our concerns were very helpfully addressed when the Department subsequently published FAB 2012-02R, which removed the issue. However, in the event that the Department decides additional guidance is needed with respect to brokerage windows, we ask the Department to very carefully consider what impact the guidance might have on all types of plans or accounts that utilize a brokerage window or similar feature, including SEPs and SIMPLE IRAs.

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Again, we appreciate both the opportunity to provide a response to the RFI on the subject of brokerage windows and the Department's efforts to engage the public in its continuing work through use of the regulatory process to improve the retirement security of all employees. If you have any questions or would like to discuss these comments further, please contact me at 202-289-6700.

Sincerely,

Lynn Dudley
Senior Vice President,
Global Retirement & Compensation Policy

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[10] *See* letter cited *supra* note 9.